



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Date: 5/19/06

Contact Person:

Identification Number:

Telephone Number:

4942.00-00

Employer Identification Number:

Legend:

A =

B =

C =

x =

Dear :

We have considered A's request for a ruling regarding approval of a proposed set-aside of A's undistributed income for the year that ended on December 31, 2004, under the suitability test of section 4942(g)(2)(B)(i) of the Internal Revenue Code, and Section 4942(a)-3(b)(2) of the Foundation and Similar Excise Taxes Regulations. The amount of the requested set-aside is \$85x.

A is exempt under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code. A seeks a ruling allowing it to set-aside funds to be paid in support of a scholarship program. This program will be administered by an unrelated 501(c)(3) organization, C.

In late 2004, A was contacted by B about the prospect of A making a significant contribution to fund a scholarship program. Between late 2004 and early 2005, A committed to the contribution of approximately \$85x. The commitment is to be made to and administered by C, a 501(c)(3) public charity which has knowledge and experience with such programs. The \$85x was paid on December 20, 2005.

A's commitment will be used by C to fund the following undertakings of B: (1) support of religious studies by students in hostile contexts; (2) training indigenous church leaders; and (3) supporting a series of theological mission workshops.

The funding of a scholarship and training program of this magnitude--involving the direct support of dozens of students across the globe—was an unfamiliar undertaking for A. However, A had some level of confidence that this project would be feasible based on C's knowledge and experience with such scholarship programs.

Against this backdrop, A determined that it would be most prudent to retain the funds until it had time to evaluate requests from a number of individual grantee scholars and get a sense of both the bona fides of the program and its charitable outcomes. However, given the remote locations and difficult conditions under which the grantees were residing, it was clear that these reports would not be fully available until after March 15, 2005. Accordingly, A has elected to treat \$85x as a set aside for this program for the year 2004.

LAW:

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for charitable and/or the other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code that are private foundations subject to the private foundation provisions of Chapter 42 of the Code.

Section 4942 of the Code imposes excise tax on any private foundation that does not expend qualifying distributions for exempt purposes at least equal to its distributable amount for its tax year.

Section 4942(g)(1) of the Code provides that, in general, a qualifying distribution is any amount, including reasonable and necessary administrative expenses, paid to accomplish, or to acquire an asset used directly in carrying on, one or more of the purposes described in section 170(c)(2)(B) of the Code, which includes charitable purposes.

Section 4942(g)(2)(A) of the Code provides that an amount of income that is set aside for a specific project within one or more purposes of section 170(c)(2)(B) of the Code may be treated as a qualifying distribution if the amount meets the set-aside requirements of section 4942(g)(2)(B) of the Code.

Section 4942(g)(2)(B) of the Code provides, in pertinent part, that an amount set aside for a specific project may be treated as a qualifying distribution if, at the time of the set-aside, the private foundation establishes to the satisfaction of the Secretary that the amount set aside will be paid for the specific project within five years and that the suitability test for a set-aside under section 4942(g)(2)(B)(i) of the Code is met.

Section 4942(g)(2)(B)(i) of the Code provides a suitability test in which the private foundation at the time of the set-aside must establish to the satisfaction of the Secretary that the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds.

Section 53.4942(a)-3(b)(1) of the Foundation and Similar Excise Taxes Regulations provides that the amounts of income set aside for a specific project for one or more of the purposes in section 170(c)(1) or 170(c)(2)(B) of the Code may be treated as qualifying distributions for the tax year(s) in which such amounts are set aside, but not in the tax year in which actually paid, if the requirements of section 4942(g)(2)(B)(i) of the Code are met, the foundation establishes to the satisfaction of the Commissioner that the amount set aside will be paid for the specific project within 60 months after it is set aside, and the set-aside otherwise meets the suitability test of section 53.4942(a)-3(b)(2) of the regulations.

Section 53.4942(a)-3(b)(2) of the regulations provides that its suitability test for a set-aside is met if the foundation establishes that the specific project is one in which relatively long-term grants or expenditures must be made. The regulation cites, as an example of a suitable project, a plan to provide matching grants.

Section 53.4942(a)-3(b)(7)(i) of the regulations provides that a private foundation must obtain Internal Revenue Service approval of its set-aside of income under the suitability test by applying before the end of the tax year in which the amount is set aside.

Rev. Rul 75-511. 1975-2 C.B. 450, holds that a private foundation, whose primary activity is the making of renewable scholarships and fixed sum research grants that normally run for three years, for which payments have been made annually from current income, may not treat set-aside amounts representing the maximum for each grantee from which the annual payments will be made as qualifying distributions under section 4942(g)(2) of the Code.

ANALYSIS:

A has sought timely approval of its set-aside of income in advance of the time when the amounts of income are to be set aside, as required by section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(7)(i) of the regulations.

A's set-aside of 85x for a specific project is within the charitable purposes of section 170(c)(2)(B) of the Code, as required by section 4942(g)(2)(A) of the Code and section

53.4942(a)-3(b)(2) of the regulations.

A represented that its income to be set aside for this specific project will be paid out for this project within 60 months from the time when the first amount is set aside, as required by section 4942(g)(2)(B) of the Code and section 53.4942(a)-3(b)(1) of the regulations. Indeed, A has represented that the funds were distributed by the end of 2005.

A's project is better accomplished by this set-aside of income, rather than by immediate payment, under the suitability test of section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations because this set-aside will allow it to perform due diligence by reviewing the reports and requests from the ultimate individual scholar grantees, which because of the difficult communications problems involved could not be done within the normal period allowed for year 2004 grants. The circumstances here are somewhat unique and unusual, and are readily distinguishable from Rev. Rul. 75-511, 1975-2 C.B. 450.

Accordingly, we rule that A's amounts of income of up to 85x dollars to be set aside for the purpose of providing funding for the above described scholarship program will be a qualifying distribution under section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(2) of the regulations in its tax year when such amount is set aside.

Section 53.4942(a)-3(b)(8) of the regulations provides that any set-aside approved by the Internal Revenue Service must be evidenced by the entry of a dollar amount in your books and records as a pledge or obligation to be paid at a future date or dates. Further, the amount of the set-aside must be taken into account in determining your minimum investment return (see section 53.4942(a)-2(c)(1) of the regulations), and any income attributable to a set-aside must be taken into account in computing your adjusted net income (see section 53.4942(a)-2(d) of the regulations).

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Please keep a copy of this ruling in your organization's permanent records.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

/s/

Debra J. Kaweck
Manager, Exempt Organizations
Technical Group 2

Enclosure: Notice 437